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***VIA HAND DELIVERY***

Lawrence Strickling
Chief, Common Carrier Bureau
Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
Washington, DC 20554

Re: *Ex Parte*
"Fresh Look"
CC Docket No. 99-142

Dear Mr. Strickling:

MGC Communications, Inc. d/b/a Mpower Communications Corp. ("Mpower") urges the Commission in this proceeding [1] to establish a "fresh look" opportunity by preempting state enforcement of unreasonable termination penalties pursuant to Sections 253(a) and (d) of the Communications Act.[2]

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[1] *Establishment of Rules to Prohibit the Imposition of Unjust, Onerous Termination Penalties on Customers Choosing to Partake of the Benefits of Local Exchange Telecommunications Competition*, KMC Telecom Inc. Petition for Declaratory Ruling, CC Docket No. 99-142 (filed April 26, 1999).

[2] Section 253(a) provides that "[n]o State or local statute or regulation, or other State or local legal requirement, may have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service." 47 U.S.C. Section 253(a). Section 253(d) directs the Commission to preempt any such state legal requirement after an opportunity for notice and comment. 47 U.S.C. Section 253(d).

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**ILEC Termination Penalties Harm Competition**

The record in this proceeding establishes that unreasonable ILEC termination penalties harm competition. CLECs have cited numerous instances in which they are unable to provide service desired by a customer because of ILEC termination penalties.[3] Indeed, Mpower continues to experience situations in which a customer is unable to consider switching to Mpower's better and more affordable service because of ILEC termination penalties. Information already submitted in this proceeding indicates that BellSouth has imposed termination penalties on nearly three thousand customers in Florida alone.[4] It appears that the amount of termination penalties imposed on BellSouth's customers of Primary Rate Interface ISDN service in Florida alone as of 1999 was at least $42 million.[5] In addition, it is abundantly clear that ILECs have imposed termination penalties for the purpose of anticompetitively locking up customers. Information submitted in this docket also shows that BellSouth's and GTE's imposition of termination penalties in Florida skyrocketed after the passage of the 1996 Act.[6] This information presents the number of tariffed term plans entered into each year by BellSouth and GTE sorted by expiration date. For example, BellSouth prior to 1996 entered into 33 tariffed term plans with an expiration date of January 2000, but 331 of

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3 Comments of Allegiance Telecom, Inc. at 2; Joint Comments of CTSI, Inc. and RCN Telecom Services, Inc. at 3; Joint Comments of Choice One Communications and Hyperion Telecommunications, Inc. at 2; Joint Comments of the Association for Local Telecommunications Services, Net2000 Communications, Inc., and Teligent, Inc. at 2-3; Comments of Columbia Telecommunications, Inc. d/b/a aXessa at 1; Comments of Fairpoint Communications Corp at 2-3; Comments of McLeodUSA Telecommunications Services, Inc. at 2; Comments of MCG Communications Inc. at 3-5; Comments of Telecommunications Resellers Association at 3; Comments of Qwest Communications Corporation at 4.

4 BellSouth Response to Staff Fresh Look Data Request, Docket No. 980253-TX, Florida Public Service Commission, filed April 30, 1999, Exhibit CNJ-1, p. 2.

5 *Id.* Item No. 7.

6 GTE Florida's Responses to Staff's Data Request On Fresh Look Policy, Docket No. 980253-TX, Florida Public Service Commission, filed April 29, 1999, "Number of Outstanding Eligible Tariffed Term Plans by Quarters;" BellSouth Response to Staff Fresh Look Data Request, Docket No. 980253-TX, Florida Public Service Commission filed April 30, 1999, "Number of Outstanding Eligible Tariffed Term Plans by Quarters."

such plans in 1996 or later.[7] For tariffed term plans expiring in January 2003, it entered into 3 before 1996 and 105 in 1996 or later.[8] Similarly, prior to 1996 GTE entered into 7 tariffed term plans with an expiration of January 2000, but 270 of such plans in 1996 or later.[9] These figures are representative for these carriers of all the tariffed term plans that these carriers entered into in Florida before and after passage of the 1996 Act. This shows that these ILECs imposed unreasonable termination penalties merely to lock up customers in the face of the imminent prospect of competition caused by the 1996 Act. Moreover, there is no reason to assume that BellSouth or GTE or any other ILEC has disproportionately used termination penalties in certain states. Therefore, the substantial numbers and magnitude of ILEC termination penalties found in Florida is probably characteristic of the nation as a whole. If the $42 million in termination liability that BellSouth could impose in Florida is extrapolated to the rest of the country, ILECs may well have imposed nearly $1 billion in termination penalties. Accordingly, the record in this proceeding strongly suggests that ILECs' use of termination penalties is widespread and of very significant magnitude.

In addition, ILEC termination penalties frequently have no reasonable economic justification. As pointed out in this proceeding, ILECs are imposing the full price of the contract as a termination penalty, as if service had never been terminated.[10] Such termination penalties have no reasonable economic basis, and are not tailored in any reasonable way to compensate the ILEC for any costs or revenues that will not be recovered due to the termination. Instead, they are designed to achieve the anticompetitive goal of making sure the customer is not able to switch to a competitor.[11]

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[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *See generally* KMC Telecom, Inc. Petition for Declaratory Ruling, CC Docket No. 99-142; *Id.* p. 4, citing Section A42.3.2A.2 of BellSouth's North Carolina tariff for ISDN service; *Id.* p. 5, citing Section 48.8.3 of SWBT's Kansas tariff for Select Video Plus Control; *Id.* p. 6, citing Section 11.B.8.3 of Bell Atlantic's Virginia tariff for Digital Dial Service.

[11] A federal jury in Oklahoma recently awarded competitive carriers $7.4 million in damages against Southwestern Bell for anticompetitive practices, including using restrictive long term contracts, in connection with pay telephone services."Antitrust Case Lost by SW Bell - Jury Awards Millions in Pay Phone Lawsuit," The Oklahoma Publishing Co, May 2, 2000, http://archives.oklahoman.com/cgi-bin/artget?filename=/.../2112937.txt&archives=957543086_1.

These ILEC termination penalties are analogous to punitive contract penalties that have no relationship to possible real economic loss. Such penalties have long been held unenforceable and void as against public policy.[12] They are also analogous to contracts of adhesion in which the parties have unequal bargaining power and one party has no alternative to accepting unfavorable terms. Most ILEC termination penalties are imposed in circumstances where the customer does not have a choice of competitive service provider. Even four years after enactment of the 1996 Act, CLECs serve only a small percentage of the nation's access lines.[13] Thus, the customer had no choice but to accept the penalty or not receive service. Contracts of adhesion are also against public policy.[14] In addition, the Commission should be greatly concerned by the fact that many customers had no actual knowledge of termination penalties at the time they entered into long term service arrangements with the ILEC. Most customers do not have the time or the ability to identify termination penalties buried in massive ILEC tariffs or contracts. For the same reason, and in view of the punitive nature of these contracts and their harm to competition, the Commission should give no weight to ILEC arguments that customers have constructive notice of these penalties because they are in publicly filed tariffs.

Mpower also emphasizes that CLECs do not have the resources to effectively seek redress of unreasonable ILEC termination penalties on a customer-by-customer, or even state-by-state basis. It is prohibitively expensive in both time and resources for CLECs to attempt to do so. Only ILECs have the resources to proceed on that basis. Accordingly, it is very important for the Commission to establish a fresh look opportunity that will apply in every state and across all markets. As discussed below, the Commission may do so under Section 253 of the Act.

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12 *See* Restatement (Second) of Contracts Section 355; *See* also *Thyssen, Inc. v. S.S. Fortune Star*, 777 F. 2d 57, 63 (2nd Cir. 1985)(applying Section 355 even in cases of intentional breach); and *Brand Iron, Inc. v. Koehring Co.*, 595 F.Supp. 1037 (MD 1984) (denying punitive damages for breach of contract). *See also* Restatement (Second) of Contracts Section 365, note a ("the central objective behind the system of contract remedies is compensatory, not punitive.").

13 In 1998 the CAP/CLEC share of nationwide local service revenues was 2.4%. *Local Competition: August 1999*, Industry Analysis Division, Table 2.1 (rel. August 1999).

14 *See* Corbin on Contracts Section 559A *et seq* (Fall 1999 Cumulative Supplement). *See also Spence v. Omnibus Industries*, 44 Cal. App. 3d 970, 974 (1975) (describing the "strong judicial concern regarding the weaker bargaining powers of consumers.); *see generally* Farnsworth on Contracts Section 4.28 (1990); and Witkin Summary of California Law, Ninth Ed. Section 23, Contracts of Adhesion.

The Commission has acknowledged the validity of concerns that ILECs use termination penalties to thwart competitive entry into local service markets. In the *Pricing Flexibility Order*, the Commission stated that "[t]o the extent the [ILEC] can lock in the larger business customers whose traffic would economically justify the construction of new facilities, the [ILEC] can foreclose competition ..."[15] and that "[a]n incumbent can forestall the entry of potential competitors by 'locking up' large customers ..." In the *Bell Atlantic 271 Order,* the Commission recognized that penalties to terminate a contract in order to take service from another provider could, in certain circumstances, be unreasonable or anticompetitive.[16] Mpower submits that the Commission's concerns are fully warranted and that it should now promptly take steps in this proceeding to assure that ILEC's may not use termination penalties to thwart competitive entry and harm customers.

**The Commission May Preempt ILEC Termination Penalties Under Section 253**

<u>ILEC Termination Penalties Are State "Legal Requirements" Under Section 253(a)</u>. ILEC termination penalties are ordinarily established in ILEC tariffs for local services filed at the state level. In some cases, these tariffs may be specifically approved by the state commission. In other cases, the state commission may have permitted the tariff to take effect. However, any termination penalty established in a tariff filed at the state level constitutes a state legal requirement within the meaning of Section 253(a) of the Act because state law requires carriers to file tariffs and offer service in accordance with the terms and conditions of the tariff. Moreover, any state action to enforce the termination penalty would constitute a state requirement that the Commission may preempt under Section 253(a) and (b). Accordingly, termination penalties in ILEC state tariffs for local services, and/or the associated state laws authorizing or permitting their enforcement, constitute

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15 *Access Charge Reform, et al.*, Fifth Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262, CC Docket No. 94-1, CCB/CPD File No. 98-63, CC Docket No. 98-157, (rel. August 27, 1999) (*"Access Charge Reform Order*"), ¶ 79.

16 *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York*, CC Docket No. 99-295, FCC 99-404, *Memorandum Opinion and Order,* (rel. December. 22, 1999), ("*Bell Atlantic 271 Order*"), ¶ 390. The Commission determined that the termination penalties brought to its attention in that proceeding "on their face" would not result in a carrier's noncompliance with the competitive checklist, but further stated that "issues raised by parties in this proceeding relating to contract termination liability are more appropriately resolved in the context of [KMC's petition], and we thus decline to resolve the issue in this proceeding." *Id.*

state requirements that are proscribed by Section 253(a) if they "have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."[17]

Termination Penalties Have the "Effect of Prohibiting" Provision of Local Service. In its guidelines for petitions seeking rulings under Section 253 of the Act, the Commission stated that parties should explain with particularity how any such requirement has the "effect of prohibiting" provision of any telecommunications service.[18] Parties should identify what is the specific requirement that has this impact, and what services are effectively prohibited from being provided, including what customers are denied access to the service, and what are the factual circumstances that caused the inability to offer the relevant telecommunications service.[19]

As described above, ILEC termination penalties are unreasonable, designed to deter customers from switching service to competitors, and are successful in that regard. Mpower has experienced many situations in which a prospective business customer has entered into a multi-year contract for a service, for example for Centrex service, with the ILEC. In many instances the customer chooses not to switch service from Mpower because the savings in receiving service from Mpower are outweighed by the termination penalties that would be imposed by the ILEC. Accordingly, these termination penalties "have the effect of prohibiting the ability of [CLECs ] ... to provide any interstate or intrastate telecommunications service" to the customer subject to these termination penalties.

There is no serious issue of whether these termination penalties "have the effect of prohibiting service" to a particular customer subject to the penalties. Rather, the only issue concerning the "effect of prohibiting" standard is whether a state legal requirement that acts as a barrier to provision of a service to a customer. Mpower believes that this issue is one of first impression for the Commission. As discussed below, the Commission should determine that state legal requirements that apply directly to customers and that effectively prohibit customers from making competitive choices are subject to preemption under Sections 253(a) and(b).

The Commission May Preempt State Barriers Applicable to Customers. Section 253(a) declares unlawful any state action that has the effect of prohibiting a carrier from provision of any

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17 47 U.S.C. Section 253(a).

18 *Suggested Guidelines for Petitions For Ruling Under Section 253 of the Communications Act*, Public Notice, FCC 99-295, released November 17, 1998, p. 2.

19 *Id.*

telecommunications service.[20] This section is arguably clear insofar as it is interpreted to require that the state legal requirement must have the effect of prohibiting in some sense provision of any telecommunications service. Prohibition on provision of any service within a geographic area, market, or to a specific customer would all seem to fall squarely within the language of the statute. In each instance the carrier is prohibited from provision of any service, although the scope within which the prohibition operates is different in each case. In short, the statute is ambiguous as to the scope within which the prohibition must operate in order to transgress Section 253(a). The statute does not say whether, in order to transgress Section 253(a), the effect of the state requirement prohibiting provision of any service must operate throughout a geographic area or market or can merely operate against some customers in a market.

It is well settled that when statutory language is ambiguous, the Commission must turn to the legislative history to illuminate what Congress intended.[21] In this case, the legislative history is also totally silent. Accordingly, the Commission should interpret the statute in accordance with the overall purposes of the Act.[22]

In this connection, it is clear that interpreting Section 253(a) of the Act to prohibit state legal requirements that apply to customers and that have the effect of preventing them from choosing to receive a service from a competitor would promote the goals of the Act. Congress intended the 1996 Act to bring to consumers the benefits of competition including greater service choices and lower prices. ILEC termination penalties operate directly against customers to prevent them from achieving those benefits. Mpower cannot emphasize enough that these termination penalties harm customers subject to them. In order to exercise the competitive choice that Congress intended to give them in the 1996 Act, customers must pay unreasonable termination penalties. Alternatively, the customer may choose not to switch service to a competitive carrier, as ILECs have intended. These termination penalties are also unreasonably discriminatory in that they impose costs on customers without any reasonable economic justification. Accordingly, it would promote the goals of the Act to interpret Section 253(a) to proscribe state legal requirements directly applicable to customers and that have the effect of prohibiting the customer from receiving service from a competitive carrier.

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20 *See* n. 2, *supra*.

21 *Chevron USA, Inc. v. Natural Resources Defense Counsel, Inc.*, 467 U.S. 837, 842 (1984) ("*Chevron*").

22 *Chevron*, at 863.

Moreover, this interpretation would not cause an unwarranted or overbroad interpretation of the statute because it would only apply in situations where - as in the case of termination penalties - the legal requirement applies directly to customers. In order to preempt enforcement of termination penalties against customers it is not necessary for the Commission to interpret Section 253 to permit preemption of general requirements applicable to provision of a service that might preclude provision of service to some customers because the general requirement raises competitive carriers' costs. In fact, termination penalties are unique among state requirements that could have the effect of prohibiting provision of a service in that they apply directly to customers. Therefore, the requested interpretation of Section 253 would constitute a valuable, but narrow, expansion of the type of actions subject to preemption under Section 253.

## Requested Relief

Mpower requests that the Commission specifically find that ILECs have imposed unreasonable termination penalties for the anticompetitive purpose of thwarting or slowing CLEC entry. The Commission should determine that termination penalties equivalent to the full tariff or contract price are unreasonable and have the effect of prohibiting the provision of telecommunications service by competitors to customers. The Commission should preempt, pursuant to Section 253 of the Act, any state enforcement, either by a state commission or state court, of such ILEC termination penalties whether in tariffs or contracts.

It would be preferable for the Commission to provide that customers may switch to competitive service providers without any termination penalty. The Commission has previously established fresh look opportunities in which ILECs could not impose any termination penalty.[23] If necessary, the Commission could permit termination penalties in those specific instances where the ILEC demonstrates to the Commission that termination without penalty would cause substantial losses that would not be offset by public policy concerns justifying a fresh look opportunity.[24]

Alternatively, the Commission could permit state enforcement of termination penalties meeting specified guidelines. Under this approach the Commission should determine that an ILEC may impose as a termination penalty no more than the difference between (1) the amount the customer has already paid, and (2) any additional charges that the customer would have paid for the service if the customer had taken a shorter term offering corresponding to the term actually used,

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23 *Competition in the Interstate Interexchange Marketplace*, Memorandum Opinion and Order on Reconsideration, CC Docket No. 90-132, 7 FCC Rcd 2677, para. 17 (1992).

24 *See Id.* para. 26.

plus interest at the prime rate. In cases where the contract or tariff does not permit this calculation, the charges for the service used should be calculated at the rates applicable at the time the service began, for the longest term commitment that the customer would have completed. The charge for the period beyond that term should be calculated *pro rata* at the rate applicable to the completed term. The Commission adopted this approach in establishing a fresh look opportunity in the *Expanded Interconnection Proceeding*.[25]

The Commission should additionally conclude that its determinations in this proceeding apply to all ILEC telephone exchange and exchange access telecommunications services.[26] There is no reason to permit ILECs to impose unreasonable termination penalties for any telecommunications service.

Sincerely,

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[25] *Expanded Interconnection with Local Telephone Company Facilities*, Report and Order and Notice of Proposed Rulemaking, CC Docket No. 91-141, 7 FCC Rcd 7369, para. 202 (1992).

[26] ILEC termination penalties applicable to interstate exchange access service are established in federal tariffs. The Commission may establish fresh look opportunities for these services under its authority under Sections 201-205 of the Act.

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